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Alert

Life Sciences Health Industry

U.S. Supreme Court Adopts a Limited Implied Certification Theory of FCA Liability, and Establishes a Robust New Materiality Requirement

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On June 16, 2016, in the closely watched False Claims Act (FCA) case, Universal Health Services, Inc. v. U.S. ex rel. Escobar*, a unanimous U.S. Supreme Court upheld the validity of the implied certification theory of FCA liability. In so doing, the Court discarded a judicially created check some courts had imposed on the theory, and which defendants had used with some success in obtaining dismissals of FCA suits. But the Court also set forth strict new limits on the implied certification theory; announced a new, pro-defendant materiality requirement; and strongly reiterated that the statute is not intended to be used to remedy minor regulatory violations or contractual breaches.*

Development of the Implied Certification Theory The FCA imposes liability on anyone who knowingly presents, or causes to be presented, false or fraudulent claims (or requests) for payment to the federal government (Government). A little more than two decades ago, federal courts began adopting an expanded theory of FCA liability—the "implied certification" theory. Under that theory, where a company submits a claim for payment to the Government, implied in the claim is a representation of the company's compliance with applicable contractual, regulatory or statutory requirements. And if that representation is false, FCA liability may attach.

In an effort to limit this expansive new theory, companies repeatedly argued—and some courts held—that only failure to disclose violations of requirements that were "expressly designated" by the Government as conditions of payment could support liability. Many lower courts rejected this requirement, which had no apparent basis in the statutory text.

Background of the *Universal Health Services* Case Enter the relators' FCA suit against Universal Health Services. The relators alleged that Universal, a health care provider, defrauded Medicaid by submitting reimbursement claims that represented that certain services billed for were provided by particular types of medical professionals. The relators alleged that these claims were false because they failed to disclose violations of state Medicaid regulations that require staff to have certain licenses and qualifications.

The district court dismissed the suit, ruling that the implied certification theory was inapplicable because compliance with the regulations at issue was not an express condition of payment by Medicaid. The First Circuit reversed, holding that every submission of a claim contains an implicit certification of compliance with the relevant regulations, and an undisclosed violation of a condition of payment—whether express or not—renders the claim false under the FCA. Because the relevant regulations required facilities to adequately supervise unlicensed staff, and Universal allegedly violated those regulations but did not tell the Government, the First Circuit held that the relators had pleaded a viable FCA claim.

The Supreme Court's Decision In its unanimous opinion authored by Justice Thomas, the Court issued three principal holdings, vacating and remanding for the First Circuit to apply the newly articulated standards:

- *First*, the Court adopted a new—but qualified—version of the implied certification theory
- *Second*, the Court rejected the "express condition of payment" limitation on implied certification adopted by some lower courts
- *Third*, the Court laid out a "rigorous" new materiality requirement that relators must satisfy

The Court adopts a newly conceived implied certification theory Perhaps the headline of the Court's ruling is that the implied certification theory is now the law of the land. That the Court adopted some version of the theory is hardly a surprise given the justices' questions during oral argument in April. Nor does it mark a significant change from existing law, since most of the federal circuit courts of appeal already had adopted the theory, and only one circuit had rejected it.

What is significant is how the Court defines and cabins the theory. In the Court's words, "two conditions" now must be satisfied before the failure to disclose noncompliance to the Government can support FCA liability: "first, the claim does not merely request payment, but also makes specific representations about the goods or services provided; and second, the defendants' failure to disclose noncompliance with material statutory, regulatory, or contractual requirements makes those representations misleading half-truths." Merely requesting payment—without also making "specific" statements about the goods or services

the company is providing—is no longer enough to establish implied certification liability.

The Court rejects the "express condition of payment" limitation adopted by some lower courts The failure to disclose violations of legal requirements also can now support implied certification liability even if the requirements "were not expressly designated as conditions of payment." This is a change from the law in several circuits, which had adopted the "express condition" limitation to cabin implied certification liability and enable companies to determine precisely what requirements could trigger it. The Court did stress, however, that "even when a requirement is expressly designated a condition of payment, not every violation of such a requirement gives rise to liability." In other words, the "label the Government attaches to a requirement" is not determinative—rather, what matters is "whether the defendant knowingly violated a requirement that the defendant knows is material to the Government's payment decision."

The FCA has a new materiality requirement—and it appears to have real teeth Finally, the Court emphasized that misrepresentations about compliance must be material to the Government's decision to pay, a "rigorous" and "demanding" requirement. This is necessary, the Court reasoned, because the FCA is not an "all-purpose antifraud statute" or a "vehicle for punishing garden-variety breaches of contract or regulatory violations." Therefore, the Court explained, a "misrepresentation cannot be deemed material merely because the Government designates compliance with a particular statutory, regulatory, or contractual requirement as a condition of payment." Nor is a requirement material simply because the Government "would have the option to decline to pay if it knew of the defendant's noncompliance." And, perhaps circular, the Court found that "minor or insubstantial" noncompliance is not material.

Given these definitions—at least of what does *not* rise to the level of "material"—the Court proceeded to reject the Government's and First Circuit's broader definition of materiality, which provided "that any statutory, regulatory, or contractual violation is material so long as the defendant knows that the Government would be entitled to refuse payment were it aware of the violation." The Court also went out of its way to reject the notion "that materiality is too fact intensive for courts to dismiss False Claims Act cases on a motion to dismiss or at summary judgment[,]" underscoring that the new materiality test is a "familiar and rigorous one" and that *qui tam* relators still "must…plead their claims with plausibility and particularity" under the Federal Rules of Civil Procedure.

The Implications of *Universal Health Services* There is much to debate about the implications of *Universal Health Services*. At least one thing, though, seems clear: it is likely to increase the filing of new FCA suits across all industries, especially those where companies customarily make specific statements to the

Government about the goods and services they are providing. The ruling breaks new ground in its definitions of the implied certification theory and materiality, which will require lower-court development and refinement, and the standards it sets forth are not especially clear or easily administrable.

The clarity—or lack thereof—of these new FCA standards is itself a major takeaway from the Court's decision. The Court acknowledged the "concerns about fair notice and open-ended liability" fueled by the implied certification theory, finding that those concerns could be "effectively addressed through strict enforcement of the Act's materiality and scienter requirements." Arguably, though, the Court failed to provide a clear definition of materiality. Indeed, while the Court identified what materiality isn't, it did not provide much detail on what materiality is. The Court's expression of confidence that its new materiality standard will support some successful materiality challenges at the motion to dismiss or summary judgment stages is comforting to defendants. But given the fact-intensive nature of the materiality inquiry, it remains to be seen how receptive lower courts will be to dismissing FCA claims on materiality grounds.

Beyond this, the Court's decision does appear to have something good for all sides. For defendants, there are new openings to attack the theory's applicability—for example, where relators fail to plead, or cannot prove, that the defendants made any "specific representations" about the goods or services they are providing. This new "specific representations" element will be subject to the strict particularity standard that governs the pleading of FCA claims in federal court. Defendants also now have a robust materiality defense, one that cannot summarily be rejected simply because the Government expressly designated compliance with a requirement as a condition of payment, or could refuse to pay a claim based on the defendant's noncompliance.

On top of all this, the Court admonishes—more than once—that the FCA is not a broad "all-purpose antifraud statute," and is not intended to be brought to bear, along with its treble damages, to address minor regulatory violations or contractual breaches. These clear directives could be very advantageous to defendants in urging a constrained application of the statute in future cases.

For relators and the Government, there no longer is any doubt that implied certification is viable nationwide—including in the Seventh Circuit, which had rejected the theory, and in other circuits that had not yet definitively addressed it. Moreover, the Court eliminated the "express condition of payment" requirement, a significant obstacle to FCA claims in some circuits over the past decade. And, although the new materiality standard narrows the circumstances under which relators and the Government can show that the defendant's noncompliance is material, it still poses a fact-bound inquiry that may preclude dismissal on the pleadings in many cases.

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Conclusion The Supreme Court's opinion in *Universal Health Services* may be the most significant False Claims Act ruling the Court has issued in decades. How significant remains to be seen, as lower courts now will be tasked with applying the new standards established by the Court. There should be no shortage of opportunities for lower courts to do so because implied certification suits already are on the rise, and are likely to proliferate in the wake of yesterday's decision.